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GENERATING COMPETITION

Equity, Reliability and Lowest Price

Supplementary Filing: March 15, 1996

Municipal **Electric** Association

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Hon. Donald S. Macdonald, P.C., C.C., Chair
Advisory Committee on Competition in Ontario's Electricity System
40 St. Clair Ave. West
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Toronto, Ontario
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Dear Mr. Macdonald:

On January 26th, 1996 the Municipal Electric Association (MEA) filed with your Committee our report entitled "Generating Competition: Equity, Reliability and Lowest Price". That report outlined the MEA's model for restructuring Ontario's electricity system.

Since then, members and officers of the MEA have had the opportunity to meet with you, your fellow Committee members and your staff, and to follow closely the interactions you have had with the citizens of this Province. We are pleased to file with you ten copies of our supplementary submission, which, based on our experiences and observations in the last few weeks, we believe will greatly assist your Committee in better understanding the operation and implementation of the MEA's model, and help clarify some of the issues that have been raised.

We look forward to further opportunities for dialogue with you and your Committee and are prepared to meet with you at any time to answer any outstanding questions.

Yours sincerely,

Wm J Scott

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Chair

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PREFACE

On January 26th, 1996 the Municipal Electric Association (MEA) filed a written submission with the Advisory Committee on Competition in Ontario's Electricity System. The report was entitled "Generating Competition: Equity, Reliability and Lowest Price". It outlined a framework for restructuring the electricity industry in Ontario.

Since that time, members and officers of the MEA have met with the Advisory Committee and followed closely their interactions with the people of the Province. It became apparent that the Committee would greatly benefit from learning further details of the model being proposed by the MEA. This submission provides the Committee with more detailed information about the operation of the competitive wholesale market recommended by the MEA, and about the practicalities of restructuring, and regulation of, the distribution sector. In addition, it briefly addresses some of the issues raised regarding ownership, and provides an overview of the attitudes and perceptions of Ontarians towards the present electricity system.

The present document is written within the guidelines set by the Committee: that is, that supplementary submissions may be no more than fifteen pages in length. The MEA would be pleased to provide the Committee with further details of its model, if requested.

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I. THE MARKET FOR ELECTRICITY

In its main submission, the MEA has argued extensively in favour of creating a mandatory wholesale market for electricity generation. This section provides details on the operation of this market. As proposed in the MEA model, the transmission system operator, which operates the physical transmission system, and the pool operator, which operates the market for electricity, are both found in the transmission company. All purchases and sales of electricity will be made either through contracts with the pool, or through the spot market, which is also operated by the pool. All electricity transactions will attract transmission and other system charges.

Medium and Long Term Contracts

In the model proposed by the MEA, each distributor will forecast requirements and indicate to the pool operator its capacity and energy contract requirements for various periods. For example, a distributor might decide that, given the contracts it currently has in place, recent patterns of demand growth, and outlook in electricity markets, it would like to secure an *additional* 15 MW of firm power for a 10 year period at a load factor of 65%. The pool operator would aggregate all such demands over all distributors and put out tenders. Generators would then respond with offers of supply, consistent with reliability and certain technical requirements set by the transmission company, and the operator would return to distributors with the menu of lowest offer prices for contracts of various terms. In some cases, this will cause distributors to alter their initial requests for contracts. The process would iterate until market equilibrium is reached, at which point the pool operator would finalize its contracts with generators and with distributors. Under this arrangement, the purchasing power of all distributors would be concentrated in the pool operator, ensuring the lowest possible cost for the supply of power.

Just as distributors will seek to assure themselves of some degree of price stability and supply security through contractual arrangements, generators will also seek to reduce investment risk through medium and long term contracts. It is, of course, unlikely that all supply requirements will be met through contracts of this type. However, if experience in other jurisdictions is at all indicative, medium and long term contracts of one form or another will be the dominant mode of electricity exchange.

If a generator is particularly risk-averse, it would choose to supply most of its power under long term contract rather than on the spot market. On the other hand, in a market of strengthening electricity prices, a supplier may choose to rely principally on the short term market. The point is that willingness to bear risk will be a market decision and will be reflected in the price of the product.

On a regular basis, each distributor will review its portfolio of contracts to ensure that the needs of its customers are being met and that the appropriate balance between security of supply and prudently incurred risk has been struck. Customer mix, which varies from utility to utility, is likely to be an important determinant of the desirable portfolio mix -- distributors with greater load uncertainty will generally prefer to reduce dependence on long term purchases. Distributors who have stable load patterns will probably find longer term contracts more appealing. The degree of dependence on contracts, rather than on the spot market, would in part depend on the willingness of large industrial customers to commit to contracts for supply from the distribution company.

The menu of contracts offered to distributors by the pool operator will contain a range of alternatives including, but not limited to, contracts of various duration, alternative rate structures reflecting time of use and discounted rates for interruptible service.

Spot Market for Electricity

Of course, not all electricity can or should be supplied under long term contracts. The desire for secure supply will likely drive distributors to secure the majority of their needs through contract. But uncertainty about demand will result in the need to acquire electricity under short term arrangements as well. Similarly, suppliers may want to secure sales for a substantial portion of their output, but uncertainty about maintenance scheduling, reliability of facilities and the potential for taking advantage of future increases in the contract or spot prices, will cause most suppliers to want to sell some portion of their current output on the spot market.

The spot market would operate as follows.[1] Each day, the pool operator would forecast demand for each half hour period of the following day, including an allocation for spinning reserve. The operator would then subtract the amount committed under contract during each period and the remainder would be the amount that would need to be supplied by the spot market. Generators would then submit bids specifying, for each period, the availability of capacity and the price at which it is offered. Multiple plant generators would bid stepped supply functions, e.g., offering the first 200 MW at one price, the next 150 MW at another price and so on. The operator would then assemble the bids and estimate the market clearing price and quantity for each period. The list of successful bidders for each period would then be compiled. The price, known as the system marginal price (SMP), would form part of the amount paid to all generators who supply power on the spot market. In a properly functioning competitive market, the SMP should reflect the variable cost of the marginal plant.

In addition to the SMP, capacity payments may need to be established. Each day, when the pool operator forecasts supply and demand, there would still remain substantial uncertainty about each. Unexpected plant outages or surges in demand for various unpredictable reasons, such as weather, would inevitably mean that demand would not exactly match supply. A capacity payment could therefore be made for each MW declared to be available by a generator in the spot market, whether or not it is ultimately called upon.[2]

The spot market price would consist of the sum of the SMP and the capacity payment. For generators, the difference between the payment they receive and their individual marginal costs represents the contribution to their capital costs and profits.

Consider, then, a generator, say with 3000 MW of capacity, 80% (2400 MW) of which is under contract. For a particular day, the generator expects to have 2550 MW available and therefore is in a position to supply 150 MW to the spot market. Even if its marginal costs are high, so that it is unlikely to be successful in its bid, the generator will still have the incentive to bid and to declare 150 MW as 'available' in order to receive the capacity payment.

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[1] The operation of the spot market is illustrative. Alternative auction and payment mechanisms will need to be considered prior to implementation to ensure that all customers benefit fully. The mechanisms that are ultimately implemented must reflect the industry structure that is put in place, as well as the number of generators actively competing in the marketplace.

[2] In the U.K., the operator estimates a loss of load probability (LOLP) for each period, evaluates the costs to consumers of a loss of power (termed the value of lost load: VOLL) then calculates the capacity payment as LOLPx[VOLL-SMP].

If, on the other hand, for unexpected reasons, the generator has only 2300 MW of available capacity, it must purchase the shortfall of 100 MW *from* the pool at the pool purchase price, which incorporates both the SMP and the capacity payment. Thus, the spot market plays an important role in facilitating the commitments that have been made under contract and averting failure to perform.

Consider now a distributor who has an expected load of 400 MW. It has contracts in place which provide say 350 MW. The distributor must then purchase the remainder on the spot market. If the distributor has contracts in place which exceed its requirements, it could try to sell this excess back to the pool on the spot market. If the excess is sustained over an extended period of time, the distributor could attempt to renegotiate its contracts with the pool.

Long Term Market Investment

What are the incentives for investment in future generation capacity? Under the proposed model, there are two. First, medium and long term contracts will provide a direct incentive for a generator to build additional capacity or for new entrants to appear in the marketplace. Second, the capacity payment on the spot market, in addition to providing such an incentive will be an important indicator of the degree of scarcity of capacity.

Since the transmission function and pool operation will both be within the same entity, the transmission company will be in a position to best determine the sites at which new capacity will be solicited.

It should be noted that, unlike regulated environments, where a substantial portion of the capital risk is borne by the ratepayer, a competitive market for electricity will lead to significant transfer of risk to generators and their shareholders. This, of course, is neither unreasonable, nor is it uncommon in the private sector.

Distributor Contracts With Customers

It is expected that a range of contract options between distributors and their customers will develop. These would include:

- time-of-use rates: where metering is cost-effective, such rates can contribute to the overall efficiency of electricity production and consumption;

- alternate levels of service: some customers may prefer a lower level of service, such as interruptible service, which is provided at cheaper rates but has the associated risk that supply may be curtailed;

- duration of contract: customers will be offered contracts of various durations; if there is a general preference for contracts of longer duration, the distributor will generally seek to arrange longer term supply contracts with the pool and reduce dependence on spot market purchases.

Export Markets for Electricity

In the future, the market will have to address exchanges of electricity with extraprovincial entities. Although we generally see such transactions as being integrated over time into the domestic market, a number of relevant factors remain unknown at present. Among these are the future structure of electricity markets in neighbouring provinces and states, as well as any future agreements on electricity trade. It is important not to commit to a process for dealing with imports and exports until the above uncertainties are clarified.

II. RESTRUCTURING AND REGULATION OF DISTRIBUTION

Introduction

We have been asked by the Committee for advice on ways to ensure timely restructuring of the retail system.[3] The Municipal Electric Association has proposed an interim period ending in the year 2000, during which time a competitive wholesale market in electricity will be implemented and distributor restructuring could take place. Below, we provide detailed recommendations which would lead to effective and prompt restructuring.

Many considerations must enter into decisions about restructuring of distribution, including economic efficiency, community values and local conditions. Before proceeding with our submissions, we make the following cautionary observation. Distribution costs represent approximately 15 percent of the price of electricity and approximately 75 percent of those costs are capital and operating costs related to physical plant, costs that are unlikely to change; 25% of 15% is 3.75% -- a small amount within which to find justification for forced restructuring, which could, in any event, have negative effects. Furthermore, retail utilities have rates which vary widely. Contributing factors include line losses, debt load, customer density and mix, diversity, load factor, daily and seasonal use patterns, local generation, history, age and maintenance requirements of the system and capital contribution practices.

Legislative Framework

Responding to the Committee's request, we begin with an outline of legislation the Committee should recommend if rationalization is to be expedited. Clearly, the proposal for legislation must be acceptable to the current government. We have relied upon Schedule M of this government's Bill 26 as a model for promoting local restructuring studies. We have used Bill 185, passed in November 1994, as a basis for implementation. It should be understood that Bill 185 already facilitates rationalization through the transfer of approximately 300,000 Ontario Hydro rural customers to municipal utilities. Both Bills would need some adjustments, but form useful templates.

Bill 185 received support from all three political parties, Ontario Hydro and the MEA, and was "signed off" by all unions involved. The Bill is designed around the existence of the "power pool". Bill 26 uses (possibly restructured) municipalities, as the basic building blocks. Municipal boundaries are well understood by citizens, are accepted as the basis for differences in local services, and provide an appropriate legal framework for governance by utility commissions. They form a suitable basis for service area definition from the political and regulatory standpoint. In this context, the MEA model has the added advantage of flexibility in that it permits adaptation to future changes in municipal structures and boundaries. The economic rationale for restructuring, which is addressed in the MEA's submissions dated January 26, 1996, is discussed further below. In unorganized areas, appropriate boundaries would have to be developed as part of the proposed studies.

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[3] The perception that municipal electric utilities are arguing for the status quo - resisting "rationalization" of the retail level, is incorrect. About twenty utilities are seeking or studying change under Bill 185, the related Simcoe County Act or under service agreements allowable under the PCA and/or the PUA. New municipal utilities are also being studied, (e.g., Timmins). Ontario Hydro management is now resisting these initiatives (e.g. Moore Township has asked to be served by neighbouring Sarnia - a request that has been denied, without clear reason, by Ontario Hydro as regulator).

Effective January 1, 1997, the Ontario Hydro Retail utilities should be replaced with separate transitional entities governed by transitional commissions whose members would be named by government and selected from within the service area. Division of Ontario Hydro Retail is straightforward given its current structure. These transitional commissions would have the specific mandate of participating in restructuring studies and facilitating restructuring.

Local Studies: Process and Objectives

The distribution restructuring proposal put forth by the MEA requires that local studies be undertaken in order to ensure that cost-effective changes are recognized and implemented. Local commissions will bear principal responsibility to ensure that thorough and complete studies are conducted. These studies should be required by legislation, they should meet statutory criteria and cover all of the province, with 3 exceptions:

a. First Nations lands: the province cannot impose involvement on reserves under federal jurisdiction. However, First Nations should be recognized as separate entities and be permitted, indeed encouraged to establish utilities, or to participate in studies if they prefer to be supplied by others.

b. existing private distribution utilities: in order to avoid unnecessary political issues, these utilities would be encouraged, but not required, to participate.

c. exceptions approved by the regulator: in order to avoid unnecessary effort and waste, local groups should have the right to present arguments to the regulator that a full study is not necessary.

Local studies should commence by December 31, 1997 and be completed by December 31, 1998. Under Bill 185, 17 local studies are already under way, albeit restricted to their own municipal boundaries. A number of other studies looking at larger restructuring activities are also under way. If studies have not begun by December 31, 1997, the regulator should have the authority to initiate studies, with costs to be apportioned equitably among studied entities.

Cost analyses contained in the studies should encompass the following objectives.

Scale

The first objective should be to establish the efficient scale for distributors, recognizing that in certain sparsely populated regions, it may not be possible to meet this threshold. Variables that could be incorporated in the cost analyses include: customer density, customer mix and the average load per customer, remaining life of assets, assets per customer, and local labour wage rates. Differences in the nature or quality of service must be accounted for explicitly as far as possible. To allow for nonlinear scale effects, flexible regression methods should be used.

Preliminary analysis undertaken by the MEA, using semiparametric regression techniques, suggests that, after adjusting for the above variables, distribution costs remain U-shaped. Furthermore, minimum efficient scale could be as low as the 20,000 customer level.

Restructuring Costs

The second objective should be to assess the one-time costs of restructuring proposals, noting that utilities which have not expanded to municipal boundaries will be required to do so.

In order to avoid unnecessary implementation costs, load transfer arrangements should be encouraged, e.g. a utility may more easily serve a customer within the jurisdiction of a neighbouring utility by using its existing facilities, thereby averting the need for new construction by its neighbour.

Studies should be conducted under the guidance of committees comprised of two representatives from each commission, including transitional commissions, plus one municipal councillor from each affected municipality. If the committee numbers more than 15, the committee may appoint a steering committee from among its members. It will also likely appoint a working committee to do analytic work.

We note that Bill 26 has been heavily criticized for not including in the statute criteria for restructuring. We therefore suggest that the Advisory Committee on Competition should recommend that the forthcoming legislation specifically include the following restructuring criteria and study requirements:

- studies should propose appropriate utility boundaries, the number and composition of each utility commission and the process for selection of commission members;
- the resulting distribution utilities should be no smaller than a municipality, and no larger than a county, region or district;
- boundaries should be determined based on customer impact, recognizing rates, service needs and community values;
- consultation should include: affected municipal councils, First Nations, businesses of significant size or sensitivity, business groups or associations, affected unions, and the general public;
- studies should specify how distributors will meet their obligation to secure sufficient power and how contracting for power between distributors and the pool will take place;
- if a cooperative is being proposed, the services that the cooperative will provide, the utilities and/or areas that will be included, and the method of cost allocation should all be specified.

Study costs would be apportioned on an equitable basis to all participating parties.

Some distributors may find it advantageous to assess scope economies that may arise from the provision of multiple services in all or part of the electrical service territory, as a means of gaining efficiency. Efficient scale for such utilities may be lower than for those providing only electricity.

Implementation

The participating parties would name members of the initial commission. These members would hold office until the first municipal election (November 1997 or November 2000). Coinciding with municipal elections, customers in unorganized territory would vote for representatives (by mailed ballot to encourage participation and minimize costs).

The regulator would review each set of restructuring recommendations to ensure that the criteria have been met. The Minister 'shall' implement the recommendations of satisfactory studies, by Order, given new temporary authority under the forthcoming legislation.

Similar to Bill 185, assets and liabilities should move with the customer, both in the absorption of transitional (formerly Ontario Hydro Retail) utilities and in the merger and restructuring of local utilities. This is appropriate, given that transfers of physical assets and financial assets and liabilities are between public sector entities. The ratepayer should not be charged twice for the same asset. In the interest of efficiency, and where the parties agree, estimates may replace exact inventory accounting of assets.

In order to mitigate the impact of rate equalization within a restructured utility, a declining rate impact discount should be allowed for up to 5 years. Differential density rates -- e.g., distinct urban and rural rates within the boundaries of a utility -- could also be explored. Initially, the power pool should continue to pay rural rate assistance in sparsely populated areas. Once restructuring is complete, the continued need for such support should be reexamined, as many such areas will be integrated into utilities which serve areas of higher density. Any continued assistance should be structured to provide incentives for efficiency.

Staff disposition should, where appropriate, follow the process set out in Bill 185, with minor modifications to recognize that many parties may be involved. The legislation should clearly specify the processes relating to 'successor rights'.

Role of Provincial Regulator in Distributor Restructuring Process

The role of the regulator will not be to control the studies *per se* but to ensure that:

a. the studies are conducted in accordance with statutory restructuring criteria;

b. local decision makers, who will ultimately determine the restructuring initiatives in their area, have access to results of earlier studies performed throughout Ontario in order that they may make informed judgements;

c. the studies and analyses are completed within the specified time period, and include specific recommendations for restructuring that are consistent with recommendations of neighbouring utilities and with absorption of distribution currently performed by Ontario Hydro;

d. the studies provide justification for the restructuring or cost savings proposals and demonstrate that they are appropriate for their jurisdiction; in those cases where studies have not commenced by December 31, 1997, the regulator can authorize studies, make recommendations and assign costs to the local government;

e. before the end of the transition period, a provincial process is put in place for establishing and maintaining the guidelines under which utility commissions act as regulators.

As the Committee has seen from discussion at a number of the public hearings, yardstick competition already exists. This competition could be substantially reinforced. The regulator could be given the authority to ensure that performance indicators are developed and implemented. Unlike the provision in Bill 26, we would suggest that the regulator would only impose the measures as a last resort. Responsibility for their development should reside collectively with the distribution utilities.

Finally, the regulator could play a useful mediation and/or arbitration role where there are disputes among parties to restructuring.

Other Distributor-Related Functions of Provincial Regulator During Transition Period

In conjunction with the regulator's role in establishing a competitive wholesale market for electricity supply, the regulator will have other important roles with respect to distribution, including:

a. assisting in the specification of initial parameters of contracts for power supply between the transmission company and distributors;

b. specifying the initial degree to which distributors will be required to secure a portion of supply through long term contracts with the transmission company;

c. reviewing and providing input on cooperative agreements that may develop amongst distributors;

d. ensuring that distributors have appropriate procedures in place for forecasting demand requirements.

Distributor-Related Role of Provincial Regulator Subsequent to Transition Period

The MEA recommends that distributors be regulated by local commissions. This will ensure accountability to the end-use customer. However, the usual regulatory challenges and information asymmetries will be present, making it difficult for the local commission to ensure that costs are indeed being minimized to the extent that is possible. In order to promote efficiency, the MEA has recommended that yardstick competition among distributors be expanded and that analyses of 'best practices' be performed in order to establish the potential for savings through productivity improvements.

The principal role of the provincial regulator in this process is to ensure that effective 'yardsticks' are indeed available. Many municipal utilities currently produce performance measures on a systematic basis, which are then compiled by the MEA. While additional work is necessary, these could form the basis for further development of yardstick performance measures. The provincial regulator will ensure that:

a. distributor costs are reported on a uniform and comparable basis;

b. where multiple services are being provided, costs are segregated as far as possible and uniform rules for allocation of common costs are maintained;

c. analyses are performed which adjust costs fairly for differing distributor characteristics;

d. analyses of best practices are performed on a regular basis;

e. all distributors meet technical and operational standards required to ensure safe and stable operation of the transmission system.

In summary, the provincial authority will ensure that the informational tools for regulating distribution costs are available to the local commissions. This, of course, does not require that the regulator collect the information, only that the regulator be charged with the responsibility for ensuring that it is properly accumulated.

Regulatory Role of Local Commission Subsequent to Transition Period

Regulatory authority over distributors will reside with local commissions. Such commissions will have the following areas of responsibility:

a. with the assistance of yardstick performance measures which will include indices which rank cost performance, adjusted for distributor differences, the local commission will have the authority to approve distributor operating budgets;

b. the local commission will be responsible for approval of all major capital program initiatives, capital expenditure plans and budgets; it is expected that local populations will have differing preferences for changes to the nature of services such as 'undergrounding' of distribution wires and transformers, demand side management and other programs which may involve significant capital expenditures;

c. supply to distributors will be met principally through a combination of long and medium term supply contracts with the transmission company and purchases on the spot market; the local commission will be responsible for approving contracts and, more generally, for determining the appropriate degree of price risk, and other risk, that is being undertaken;

d. local commissions will have ultimate responsibility for approving local rate structures within the broad provincial guidelines developed during the transition period; these will include long term and short term contracts for power with industrial and commercial customers as well as time-of-use rate structures;

e. it is expected that different distributors will experience different patterns of demand for energy services and perhaps differing demand for reliability; the local commission will be responsible for ensuring that the preferences of customers are reflected in the menu of choices made available by the distributing utility;

f. it is expected that, as the industry continues to evolve beyond the year 2000, further distributor restructuring is likely to occur; approval of amalgamations, cooperative ventures and other restructuring will reside with local commissions.

III. OWNERSHIP TRANSFERS AND MUNICIPAL UTILITY CONSENT

Introduction and Summary

Several of the submissions to the Advisory Committee have raised the prospect of significant transfers of ownership of various assets within the Ontario electricity system. Some proposals call for the partial or complete disposition to their parties of Ontario Hydro's assets. Some submissions also call for the transfer of municipal electric utility (MEU) assets and equity to Ontario Hydro.

The purpose of this submission is to remind the Committee that these proposals ignore the fundamental legal impossibility of effecting either of these changes without the consent of the MEUs.

Regarding the possible disposition or privatization of Ontario Hydro assets, the historical record is clear that Ontario Hydro was established as a municipal co-operative and has always held both assets and equity as trustee for the participating municipal utilities. Public statements, legal contracts and various statutes all refer expressly, or by necessary implication, to this fact. Ontario Hydro has itself many times reaffirmed its status as trustee and agent for the municipal partners. It is only in recent years, as Ontario Hydro management has sought to introduce the concept of privatization, that an active campaign has been mounted to mythologize what for many years was undisputed, and today remains indisputable - that the municipal utilities are beneficial owners of Ontario Hydro assets and equity.

Regarding municipal distribution assets, while it has become somewhat commonplace to refer to the generation, transmission and distribution assets collectively as the "electricity system", it is only truly a system from an engineering point of view. From an ownership perspective, it is clear that Ontario Hydro has no ownership interest of any nature in the distribution assets of the local utilities and cannot effect any transfer of those assets unilaterally.

Ontario Hydro Assets

The political origins of Ontario Hydro (then the Hydro-Electric Power Commission of Ontario) have never been seriously disputed. *The Ross Power Act* (S.O. 1903, c.25) was enacted in 1903 to give effect to the desire of a number of municipalities to form a collective to fight against the private monopolies and to utilize the large water power resources of the province to ensure a cheap supply of power for the burgeoning industrial base of the Ontario economy. The 1903 legislation unmistakably saw the enterprise as a municipal co-operative, to be funded by the municipal partners themselves through municipal debentures. The report of the Commission established under the 1903 legislation recommended that the interested municipalities proceed with a co-operative for both transmission and generation of electricity. In 1906, following the legendary march on Queen's Park led by Sir Adam Beck, the government created the Hydro-Electric Power Commission (the "Commission") as a permanent body (*Power Commission Act,* S.O. 1906, c.15). Though the Commission would operate the undertaking as trustee, the enterprise remained fundamentally a municipal co-operative, funded by municipal debt through the sinking fund mechanism and with expansion determined by municipal referendum.

The trust relationship between the newly established commission and the municipal partners was reaffirmed by statute a few years later. In 1917, the *Ontario Niagara Development Act* (S.O.

1917, c.21) was passed to permit the Commission to develop its own generating station at Niagara. Section 6(1) of the Act specifically declared that "the Commission is to be a trustee of all of the works constructed or acquired under the authority of this Act for the municipal corporations which have heretofore entered or may hereafter enter into contracts with the Commission for the supply of electrical power...".

Thus, there can be no mistake that Ontario Hydro was, at its inception, an agent and trustee for the participating municipalities. Nor has this changed. Both Ontario Hydro and the government have reaffirmed this proposition over the years.

For example, the contracts entered into between the Commission and participating municipalities expressly constituted the Commission "a trustee of all property held by the Commission under this Agreement...". In 1924, in a publication entitled *"The Hydro-Electric Power Commission of Ontario - Its Origin, Administration & Achievements"*, the Commission described its undertaking as a "co-operative municipal-ownership enterprise" and described itself as "agent and trustee for the municipalities". In a 1934 publication, the Commission again referred to its "trusteeship of the extensive and valuable properties of the municipalities" and described itself as a "municipally-owned electric undertaking".

Nor was the government of Ontario under any misapprehension regarding the nature of the enterprise. In 1959, then Ontario Premier Frost said (February 24, 1959, *Reply to Speech from the Throne*):

> "... Hydro is not owned by the government. Hydro emanated and is still basically an emanation of a partnership of municipalities. To put it in understandable terms, municipalities are the shareholders in the system."

Thus, while some commentators today refer to the claim of the municipal utilities to ownership of the Hydro assets as "myth", the record indicates it to be both a legal and political fact. The MEU equity accounts maintained by Ontario Hydro, and reported publicly until 1993, are not an accounting fiction, but a reflection of this reality.

To be sure, there has been no shortage of difficulty in reconciling government control of the undertaking (through its appointment power) with municipal ownership. This was one of the subjects addressed by Task Force Hydro in its work in the early 1970s. After confirming the existence of a beneficial interest on behalf of the municipalities, the Task Force recommended recognition of this beneficial interest in the form of non-voting participating shares to be given to the municipalities which would entitle them to ownership of the accumulated equity on liquidation or dissolution (*Task Force Hydro*, Report No. 1, pp 60-63). That the government of the day in the end decided not to implement this recommendation, but chose instead to preserve the status quo, did not alter the existence or nature of the ownership interest of the MEUs. The *Power Corporation Act* (S.O. 1973, c.57) of 1973 did not create a "Crown Corporation" in the sense of vesting ownership of the enterprise in the government; it remained a body corporate without share capital. The legislature simply declined to change the ownership situation, as unsatisfactory as it may have appeared to some, instead being content with the existing state of affairs. Most of the other indicia of municipal ownership (e.g. the sinking fund) were retained.

It is perhaps unfortunate that the *Power Corporation Act* did not provide for a more formal manifestation of the equitable interest of the MEUs. But the fact remains that, without an express mechanism for unilateral redemption by Ontario Hydro of the municipal ownership interest, the consent of the MEUs is clearly required if

Ontario Hydro wishes to dispose of its assets and deal with its equity out of the ordinary course of business.

We note, here, as well, that Ontario Hydro does not have the authority to privatize itself. Under the *Power Corporation Act* (Section 44(4)), Ontario Hydro only has authority to dispose of assets which are no longer required for its operations. This restriction is clear and unequivocal. Not only does it restrict Ontario Hydro's power to dispose of productive assets, but it also re-enforces the fact that Ontario Hydro's dominion over its assets is extremely circumscribed, and is limited to an operating stewardship consistent with its role as trustee of those assets on behalf of others.

Municipal Distribution Assets

It is clear beyond any doubt that Ontario Hydro has no ownership interest of any nature in the municipal distribution assets. Pursuant to the provisions of the *Public Utilities Act* (R.S.O. 1990, c.P.52) and the *Power Corporation Act* (R.S.O. 1990, c.P.18), the only connection between Ontario Hydro and the municipal distributing utilities is the contractual supply relationship and the regulatory role performed by Ontario Hydro.

The regulatory role vested in Ontario Hydro is a very narrow one and flows from coordinating the participants in the cooperative. There has never been any suggestion, nor could there be under the legislation, that Ontario Hydro has the right to initiate or unilaterally accomplish any transfer of local distribution assets. Nor does Ontario Hydro have any power of expropriation with respect to municipal distribution assets.

It thus follows that the power to effect the disposition of local distribution assets and retained equity resides exclusively at the municipal level. This fact is not changed by Ontario Hydro's proposal to give value for the assets and equity it proposes to acquire in the form of shares in a newly capitalized Ontario Hydro (this in itself is an insurmountable problem - even if it did have the power to expropriate, it could not, unilaterally, give compensation other than in the form of money). The question here is not whether Ontario Hydro is giving fair value, but whether Ontario Hydro has the authority to undertake such a transaction without the consent of the municipal electric utilities themselves. Clearly, Ontario Hydro does not have that authority.

Conclusion

In conclusion, we affirm that the municipal utilities are beneficial owners of Ontario Hydro assets and equity, and that Ontario Hydro has no ownership interest of any nature in the assets of local utilities. It is, moreover, legally impossible to effect any transfer of Ontario Hydro's or local utilities' assets without the consent of the municipal electric utilities.

IV. CONSUMERS' ATTITUDES AND PERCEPTIONS TOWARDS THEIR ELECTRICITY SYSTEM

Introduction

In January 1996 the Municipal Electric Association (MEA) commissioned Insight Canada Research to conduct a research study on the attitudes and perceptions of Ontarians towards their electricity system. The study did not distinguish between Ontarians as residential, commercial or industrial consumers of electricity. The results of the study are significant in that they demonstrate the high degree to which customer attitudes and preferences regarding the electricity industry are served by the MEA model for restructuring.

Methodology

The study was conducted by telephone between January 5th and 10th, 1996. In total, 1,200 interviews were conducted. This sample was distributed disproportionately across Ontario so as to provide the best possible accuracy in less populous communities.

Four primary sampling units (PSUs) were drawn:

- Metro Toronto
- communities with populations over 100,000
- communities with populations between 10,000 and 100,000
- communities with populations under 10,000.

From within these PSUs, representative samples of 300 were interviewed. A representative province-wide sample of 1,013 Ontarians was obtained through weighting down to reflect the provincial population as a whole. Overall province-wide results are accurate to within plus or minus 3.1%, nineteen times out of twenty.

Insight Canada Research meets or exceeds the professional standards and guidelines laid down by the Canadian Association of Market Research Organizations.

General Perceptions/Views of Ontario's Electricity System

At the current time, Ontarians do not display a large appetite for changes to the status quo in the ownership, management and supply of electricity service. This is particularly true for customers of municipal electric utilities.

A clear majority of respondents could correctly identify their electricity supplier. Note that 75% of customers in Ontario are supplied by municipal electric utilities.

Nearly three-quarters of Ontarians (72%) have a favourable attitude towards electric utilities. Favourable impressions of electric utilities are broadly based across all demographics and groups in society. They are particularly high among retired people, among whom nearly nine in ten (88%) have favourable impressions of their electric utilities and who react more favourably to electric utilities than they do toward any other institution tested. Other institutions tested included provincial and municipal governments, cable television companies, natural gas companies, long distance telephone companies, among others.

Of particular significance is the fact that most Ontarians (79%) feel they are getting reasonable value for the money they spend on electricity.

The Ontario Public's Priorities in Electricity Supply - Choice is the Lowest Ranked

Issues of security of electricity supply, reliability of supply, safety and environmental protection are of key importance to the majority of Ontarians. Moreover, the current management at municipal electric utilities is seen to be best at handling these issues.

When asked to rate in importance different responsibilities in an electricity company, Ontarians place their highest priority on public safety, reliability of supply, security of supply and safety of employees. Having a choice of companies from which to buy electricity was viewed as the **least important**, on average, out of a list of twenty-one issues tested.

Ontarians were asked which people they would prefer to run electric utility companies with respect to a range of issues: a municipal council, private industry or their current utility operator. Table 1, below, records their preferences.

Table 1 - Best Operator on Key Issues (in ranked order)

	Municipal Council	Private Industry	Current Utility Operator
Ensure public safety	35%	13%	47%
Being quick to restore power	24%	24%	49%
Ensuring reliable supply	24%	21%	49%
Security of supply*	33%	15%	48%
Ensure employee safety	32%	16%	47%
Sufficient supply for future	26%	20%	48%

* Actual phrasing used was *"ensuring a guaranteed supply of electricity"*.

Ontarians clearly feel that, across the majority of issues tested, including all the priority issues identified above, the current managers of their electric utilities are the *best to run electric utility companies*.

Attitudes Towards Specific Electricity Policies

Nearly two-thirds of Ontarians support the "obligation to serve" principle, favouring retention of an electricity policy in Ontario which sees *"each electric utility required by government to supply each customer in its own area with the electricity they need, as long as they can pay the appropriate charge - in return being granted exclusive access to its customers with no other companies allowed to supply its customers"*.

A large majority of Ontarians support the pooling principle. 81% of respondents are in favour of retaining a policy of pooling power in the province, that is, *"supplying local electric utilities with electricity at common wholesale rates, regardless of their geographic location within the province"*.

In addition, support continues to exist in the province for subsidizing the electricity rates of people who live in rural and remote areas of the province which are more expensive to serve, with over 60% in favour of continuing this policy.

Conclusion

These survey results demonstrate that municipal electric utilities fairly represent their customers' interests, interests which form the foundation of the MEA's model for restructuring the electricity industry.

Survey respondents demonstrated clearly that they prefer to maintain fairness in wholesale and retail rates. The MEA model provides for continuing equity in the delivery of electricity in this province.

A priority with the large majority of consumers in Ontario is reliability and security of electricity supply. The MEA model ensures a continuing reliable and secure supply.

Ontarians currently feel they receive value for their electricity dollar. The MEA model will result in lower prices to all consumers and will therefore continue to provide Ontarians with the value they expect.

The MEA model puts the interest of all customers first and, consistent with the desires of Ontarians that are expressed in the results of this survey, will deliver equity, reliability and lowest price.

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